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ABSTRACT

1976 saw a number of major fiscal changes occurring in New Jersey, all of which had an impact on educational funding. These include the imposition of a state income tax, a property tax rebate program, and a new system of funding public education that significantly increases the state's share of total education support. Based on a measure of the fiscal burden faced by the residents of New Jersey communities developed for this study, calculations indicate that on an average the state's larger urban communities face a fiscal burden more than four times greater than the fiscal burden in the average nonurban community. Detailed analysis of the impacts of the new tax and school funding legislation reveal that, in general, urban communities receive preferential treatment. However, the magnitude of this preferential treatment is insufficient to have a large impact on the relative fiscal position of urban as compared to nonurban communities within the state. (Author/PGD)

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STATE FINANCIAL REFORM IN NEW JERSEY AND THE URBAN FISCAL CRISIS:

A SUMMARY

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STATE FINANCIAL REFORM IN NEW JERSEY AND THE URBAN FISCAL CRISIS

THE IMPACT OF THE INCOME TAX, PROPERTY TAX REBATES AND "T&E" SCHOOL FUNDING ON NEW JERSEY'S URBAN COMMUNITIES

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Prepared for:

The Urban Education Observatory
New Jersey Department of Education

December, 1976

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This paper summarizes research which is presented in greater detail in three reports. The reports are entitled "Municipal Overburden in New Jersey: An Assessment," "Predicting the Impact of New Jersey's New Educational Funding Act (P.L. 212, 1975) on the Pattern of Local Support for Education," and "The Impact of the New Jersey Income Tax Law and Property Tax Rebate Program on New Jersey Municipalities." They are available upon request from the Urban Education Observatory, New Jersey State Department of Education, Trenton, New Jersey.

The authors wish to acknowledge the critical comments and editorial support of two individuals in particular. Robert A. Beauregard and William A. Cozzens read earlier drafts of the paper and their thoughtful comments contributed to its improvement. William A. Cozzens also provided substantial assistance with the preparation of the final draft. These individuals should, however, be absolved of any blame associated with whatever shortcomings may remain.

STATE OF NEW JERSEY
DEPARTMENT OF EDUCATION
225 WEST STATE STREET
TRENTON, N. J.

OFFICE OF THE COMMISSIONER

January 17, 1977

On behalf of the Department of Education and the Educational Improvement Center of Northeast New Jersey, I am pleased to present "State Financial Reform in New Jersey and the Urban Fiscal Crisis," one in a continuing series of reports developed by the New Jersey Urban Education Observatory.

This report, prepared by Professors Andrew Reschovsky and James Knickman, summarizes their analysis of the financial impact which the Public School Education Act of 1975, the new income tax, and other recent changes in the State's fiscal institutions have had on urban communities in our State. They conclude that these financial changes should benefit the urban areas of New Jersey. They point out, however, that these policy changes—as significant as they may seem—only begin to address the severe problems of our urban communities, problems stemming from the higher costs of providing services in urban areas, the greater need for services in those areas and the relative paucity of local resources.

In providing reports such as this, the Urban Education Observatory, an ESEA Title IV-C project of the Department of Education, and EIC-NE seek to direct our attention to the special conditions facing educators and municipal officials in the urban communities of New Jersey. The 28 "urban-aid" cities educate about one-fourth of all public school children in the State. If we are to be successful implementing the Public School Education Act of 1975, educators at all levels must focus at least a corresponding portion of their time, attention, and energy on the task of improving education in our urban centers. Only with a shared effort, involving the dedication and creativity of parents, teachers, and administrators, can we succeed in the task before us.

Sincerely,

Fred G. Burke
Commissioner

ABSTRACT

In this paper we assess the composite impact on New Jersey communities of a number of major fiscal changes that occured during the past year. These include the imposition of a state income tax, a property tax rebate program, and a new system of funding public education in the state that significantly increases the state's share of total education support.

We develop a measure of the fiscal burden faced by the residents of New Jersey communities. Our calculations indicate that on average, the state's larger urban communities face a fiscal burden more than four times greater than the fiscal burden in the average non urban community. Following a detailed analysis of the impacts of the new tax and school funding legislation, we find that in general, urban communities receive preferential treatment under the provision of the package of legislation. However, we conclude that the magnitude of this preferential treatment is insufficient to have a large impact on the relative fiscal position of urban as compared to non-urban communities within the state.

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I. Introduction

Nineteen seventy-six has been an eventful year for New Jersey. The state enacted its first income tax, a series of laws were designed to reduce local property tax payments, and important changes were made in the way public education is funded. These fiscal changes have come in response to the ruling of the State Supreme Court in Robinson v. Cahill that declared unconstitutional the previous method of funding public education in the state.

These fundamental changes in the tax structure and in the pattern of state aid to school districts are coming in a period of growing concern over the continued ability of American cities to provide needed public services. This concern arises from the continually increasing costs of providing services, and from the fact that many communities are facing stagnating, and in some cases, declining tax bases. The recent "fiscal crisis" of New York City has highlighted the seriousness of the fiscal problems of cities, particularly those in the older urban areas of the Northeast which share many of New York City's underlying economic problems.

In this light, we have attempted to assess the impact of New Jersey's new taxes and school finance legislation on the fiscal position of the state's urban communities. The central question we seek to answer in this paper is whether this year's new legislation will improve the relative fiscal position of New Jersey's urban communities.

In order to evaluate the impact of the new legislation we must first carefully assess the current fiscal state of health of local governments in New Jersey. Does a "fiscal crisis" now exist among New Jersey's local governments, and how can we measure its severity? To answer this question, we present some data that will

describe the fiscal position of urban and non urban municipal governments and school districts. We then develop a quantitative measure of the severity of various local governments' fiscal problems. This is followed by three sections of the paper which describe, in turn, the impact of the state income tax, the property tax rebate provisions and the new school finance ("T&E") law on both individuals and local governments in New Jersey. As a final, concluding section we combine the results of the previous sections into an overall assessment of the impact of all the new legislation on urban and non-urban local governments in New Jersey.

The analysis in this paper is based on a careful assessment of 62 communities. Our sample of 62 was chosen so as to include all 28 cities eligible to receive state aid under the "Urban Aid" program. The remaining 34, non-urban aid communities in our sample were chosen to be representative of a cross section of all types of local communities found in the state. Each of the 62 towns in our sample is classified as being either urban, suburban or rural, and being inhabited on average by residents of either high, moderate or low socioeconomic status (SES).

II. A Fiscal Portrait of New Jersey Municipalities

Before we examine the impact of the new legislation on the state's urban areas, we can first present some information which summarizes the fiscal position and problems of New Jersey's urban communities. In considering the fiscal well being of a municipal government, it is necessary to examine both sides of the ledger. On the revenue side, we must guage the resources which are available to support public services and also must consider the degree to which

local taxes draw on those resources. On the expenditure side, we must be concerned with the magnitude of demands on those resources--both the need for public services and the cost of providing those services. In this section we will present some data which summarize the position of urban and non-urban communities in these various areas.

On the revenue side, the potential resources of a municipality take the form of the wealth, or real property, in that community and the income of the community's residents. Thus, the two most common measures of resources, or fiscal capacity, are the per capita equalized value of real property and the per capita personal income of the municipality. By both these measures, New Jersey's urban municipalities are in a poor position relative to other municipalities around the state. As Table 1 indicates, the fiscal capacity of the urban aid communities is substantially lower than that of the non-urban aid communities. In 1972 per capita personal income for the urban aid

TABLE 1. Fiscal Capacity of New Jersey Communities

MEASURE OF FISCAL CAPACITY	URBAN AID COMMUNITIES	NON URBAN AID COMMUNITIES
Equalized Property Value, Per Capita, 1974	$6,309	$16,260
Personal Income, Per Capita, 1972	$3,655	$ 5,165
Total Equalized Property Tax Rate, 1974	5.18%	2.65%

cities was only 71% of the per capita personal income in the non-urban aid communities. The cities are even worse off when per capita real property is used as the measure of fiscal capacity. The cities have only 39% of the real property per capita that the non-urban communities have. One result of their lagging fiscal capacity is that the urban aid cities must impose higher effective property tax rates to finance their expenditures. As the last line in Table 1 indicates, the average property tax

rate in urban aid cities is almost twice that in non-urban aid communities.

Despite their weak realtive fiscal position, we find that the urban aid cities have relatively high expenditure levels. On a per capita basis, the urban aid cities outspend the non urban aid municipalities--$307 to $215. Even when education is included in the calculation (where non-urban aid municipalities outspend the urban aid cities $273 to $225 on a per capita basis), the urban aid cities still have higher overall per capita expenditures--$532 as opposed to $448 for the non-urban aid municipalities. As indicated in Table 2, the major budget categories where urban aid cities have significantly higher expenditures than the non urban aid communities include police, fire, health, welfare, and general government.

TABLE 2. Expenditures for Selected Budget Categories, Per Capita, 1974

BUDGET CATEGORY	URBAN AID COMMUNITIES	NON URBAN AID COMMUNITIES
General Government	$ 79	$ 34
(Judicial)	*(2)*	*(2)*
Public Safety	84	47
(Police)	*(46)*	*(31)*
(Fire)	*(35)*	*(14)*
Streets and Roads	16	20
Sanitation	17	14
Health	12	3
Welfare	5	0.5
Recreation	9	7
Debt Service, Employee Benefits, Misc.	85	89.5
Municipal Total	$307	$215
Education Total	225	273
TOTAL	$532	$488

Higher expenditure levels result from both the higher cost of providing certain services in urban communities and the need for higher levels of some services in those communities. Unfortunately, it is very difficult to sort out what precise portion of the higher per

capita expenditures in the urban aid cities can be attributed to higher costs and what portion, to higher service levels. We can, however, make some observations on factors which often are associated with higher costs and which do contribute to the need for higher service levels in the state's urban centers.

The higher costs of municipal services in urban communities stem from (a) the higher costs of providing each unit of the facilities or labor necessary to generate a given level of municipal services and from (b) the larger size of facilities frequently needed to produce those services. Frequently, wages are higher in urban settings. In most cases, workers in larger jurisdictions are heavily unionized and the unions often tend to be stronger than smaller suburban locals. Moreover, in a number of cases, higher wages are necessary to attract labor to work in the larger cities. This is particularly true of teachers and police who often demand more pay to work in the "more difficult" urban environment.

Likewise, the cost of building and operating the municipality's physical plant tends to be higher in the large city. Land acquisition costs are usually higher, while vandalism and related problems often lead to higher operating costs. And, with the recent fiscal crisis and the related fears of default on municipal bonds, the cities find that their costs of borrowing funds for capital construction have risen sharply.

In addition to higher <u>per unit</u> costs, the cities may also require larger facilities or a larger labor force to produce a given amount of some municipal service. First, labor or capital can be used more or less efficiently in the production of municipal services. Second, because of certain diseconomies of scale, higher density development may increase the facilities necessary to provide a given

level of services. For example, high rise business and residential structures require specialized fire fighting equipment to provide the same level of fire protection.

The second source of higher municipal expenditures in urban areas is the need in urban communities for more municipal services steming from the unique character of population groups and physical plant in those communities. The elderly, who tend to be concentrated in cities, require more social, medical and recreational services and also tend to require higher levels of police protection because of their age and vulnerability. The poor, also heavily concentrated in urban communities, necessitate higher levels of social, welfare and housing services. The physical plant of the big city which is older, of higher density, and frequently deteriorating also generates a need for higher levels of municipal service. The liklihood of fire is greater, requiring more fire protection or prevention. Physical deterioration also leads to a need for higher levels of code enforcement activities, rehabilitation services and even urban renewal.

In summary, although we do not know what portion of the higher municipal expenditures encountered in urban communities can be attributed to higher costs and what, to the need for higher service levels, we can see that on both of these counts, the urban aid cities may require higher expenditures just to meet their basic needs.

As interesting as these statistics on local fiscal capacity and municipal expenditures are, neither set of statistics can stand alone as an adequate measure of the relative financial position of various communities. If one only looks at the data on fiscal capacity--incomes and property values--then there is a risk of ignoring both the higher costs of providing services and the greater need for services in

urban districts. If one only looks at expenditure data, then there is a risk of ignoring both the relative fiscal capacity of different communities and the composition of those expenditures. A well-to-do community with high expenditures levels may be spending a large portion of that money on tennis courts, swimming pools, 5-day-per-week trash collection, or other "frills" instead of spending it on more basic "necessary" services. Also comparison of expenditures is not always a good relative measure of fiscal position because different communities may receive very different grants or intergovernmental transfers. These grants do not cost the local resident as much as they boost expenditure levels.

It would be desirable to have a measure of relative financial position which would incorporate as many of these factors as possible. Using a multi-variate statistical procedure, we have developed just such a measure.* We argued, in effect, that every community must provide some "minimum bundle" of required or necessary municipal services. The size of the minimum bundle will vary across different communities depending on the many factors discussed above on pages 3-7. Our statistical procedure allowed us to calculate the approximate per capita dollar cost of just such a minimum bundle of services taking into account population and community characteristics which affect both the size and cost of the minimum bundle.

The second column in Table 3 presents approximate costs of minimum bundles for the New Jersey communities in our sample. Above the dashed line, the contrasting costs of minimum bundles for

*This methodology is discussed in detail in our paper, "Municipal Overburden in New Jersey: An Assessment." (Trenton, NJ: Urban Education Observatory, 1976.)

Urban Aid and non-urban aid communities are depicted.

TABLE 3. Per Capita Cost of "Minimum Bundles" and Municipal Overburden Index, by Type of Community

COMMUNITY TYPE	NUMBER OF COMMUNITIES IN EACH TYPE	PER CAPITA COST OF MINIMUM BUNDLES	MUNICIPAL OVERBURDEN INDEX
Urban Aid	28	$295	.039
Non Urban Aid	34	135	.008
	62		
Urban, Low SES	28	$294	.039
Urban, Moderate & High SES	10	160	.012
Suburban, Low & Moderate SES	6	153	.006
Suburban, High SES	8	116	.006
Rural, Low, Moderate & High SES	10	106	.008
	62		

Below the dashed line, the minimum bundle costs for the same communities categorized in a different fashion are depicted. These results are very interesting, especially when compared to the per capita expenditure data presented in Table 2. If we compare the per capita cost of the minimum bundles with per capita municipal expenditures, we see that urban aid cities are barely spending enough to provide the minimum bundle of services. The cost of the minimum bundle is $295 while they are spending $307. In contrast, the non-urban aid communities are spending $215 per capita while the average per capita cost of their minimum bundle is only $135. Although we of course cannot say for sure that $295 of the $307 spent by the urban aid cities is actually going for services included in the minimum bundle, these comparisons do suggest that the non-urban aid communities have much more room for discretionary expenditures.

To arrive at a fair comparison of the fiscal position of various communities we must also look at the effort needed by citizens to provide the minimum bundle of required services. Because communities have differing property values and incomes, some will have to tax themselves more heavily to provide a given minimum bundle. The right hand

column in Table 3 gives a "municipal overburden index" for our sample communities. This index can be interpreted as the local property tax rate necessary to raise enough money to purchase the community's minimum bundle (.039 equals a 3.9% property tax rate). It is called an "overburden" index because it measures the extra burden which poorer communities must bear to provide their minimum bundles of services.

The tax rate necessary to provide the minimum bundle in urban aid communities is almost 5 times the rate necessary to provide the minimum bundle in non-urban aid communities. In certain specific urban communities the index is considerably higher still. For example Newark's index is .074 and Camden's is .050. Clearly, some of the difference in overburden index values between urban aid and non-urban aid communities stems from the larger minimum bundles in the urban aid communities but it also is a result of the much smaller per capita tax base.

The comparisons of minimum bundles and municipal overburden between urban aid and non urban aid communities in no way contradicts the earlier discussion of expenditures and fiscal capacity. Instead these comparisons clarify the point that New Jersey's urban communities are, in relative terms, much worse off than the non urban communities.

Given that the urban municipalities in New Jersey are in such a weak fiscal position relative to other municipalities, the question becomes: How will the new statewide fiscal reforms affect the financial status of the urban areas? Can the income tax, the property tax rebates and the "T&E" school funding formula conteract such severe municipal overburden? In the next three sections of this paper we will examine the effect of these recent fiscal reforms and attempt to answer the above questions.

III. The Income Tax

In order to predict the impact of the new state income tax on various New Jersey communities, it is necessary to know the distribution of household income and exemptions across the state. The total effect of the tax in each community will depend on how many people in that community earn more or less than $20,000 as well as the number of specific exemptions. The most recent information on community income distributions is 1969 data from the U.S. Census and the U.S. Internal Revenue Service. In order to update these income data to 1976, we used a rather complex estimation procedure.* In essence this procedure used 1976 wage rate data for selected occupations to "inflate" the 1969 income data to 1976 levels. To determine the current pattern of exemptions by community, estimates of the number of dependents, the number of elderly (over 65 years of age), and the number of children enrolled in private schools were also made by "aging" 1969 census and I.R.S. data up to 1976.

The estimates of taxable income and income tax liability obtained using this procedure are depicted in Table 4. The estimates show clearly the wide range of taxable incomes across different New

*Details of this estimation procedure are available in a paper available from the NJ Urban Education Observatory: James Knickman and Andrew Reschovsky, "The Impact of the New Jersey Income Tax Law and Property Tax Rebate Program on New Jersey Municipalities," 1976. The data on taxable income and income tax liability are based on the estimate of the number of filing units (returns)--both individual and joint--in each town. Taxable income is calculated by subtracting the value of all exemptions from aggregate gross income. In addition, all income of taxpayers earning less than $3,000 is excluded from taxable income. Aggregate income tax liability is then calculated by taking 2% of all taxable income below $20,000, and 2½% of taxable income above $20,000, and then applying the $65 homestead credit to the tax of all renters.

Jersey communities. The average taxable income in the high SES suburban communities is more than two and one half the level in the state's poor urban communities.

TABLE 4. Average Per Unit Taxable Income and State Income Tax Liability, by Type of Community

COMMUNITY TYPE	AVERAGE PER UNIT TAXABLE UNIT	AVERAGE PER UNIT INCOME TAX LIABILITY
Urban Aid	$ 8,319	$173
Non Urban Aid	15,531	330
Urban, Low SES	$ 8,458	$176
Urban, Moderate & High SES	13,691	289
Suburban, Low and Moderate SES	14,132	298
Suburban, High SES	21,045	455
Rural, Low, Moderate & High SES	9,850	205

There is, however, considerable variation in taxable income among different communities. For instance, among the urban aid cities per unit taxable income varies between $14,501 in Atlantic City and $14,392 in Montclair. Among the non-urban aid communities, taxable income varies from $7,392 in Middle Township (a rural community) to $23,658 in Millburn (a suburban community). As is expected lower income tax liability is found in communities with lower incomes. The average per unit tax liability in high SES suburban towns is over 2½ the tax liability in low SES urban places.

One way to compare the average impact of the income tax on different communities is to calculate the average effective tax rates. These indicate the actual tax paid as a proportion of gross (before tax) income. Although two households of the same size and economic circumstances will pay identical taxes regardless of their place of residence, the average tax payment as a proportion of total

income in urban communities will be considerably lower than the same figure in most suburban communities, because most urban communities have a relatively large number of low income households, who are exempt from all tax payments. In addition, many of New Jersey's more urban communities have high concentrations of elderly, who in addition to their generally lower incomes, are entitled to extra exemptions. The average effective tax rate for all urban aid cities is 1.33%, while the average effective tax rate in the non-urban aid communities in our sample is 1.66%. Atlantic City, with its large proportion of poor and elderly has an average effective tax rate of 1.12%. Newark's effective rate is 1.24%, while the average rate in Millburn is 1.91%, and in Cinnaminson, 1.76%. In these towns with higher effective rates, a substantial portion of the tax paying units earn at least $20,000 in taxable income and thus are subject to the nominal tax rate of 2.5% on part of their income. It should also be noted that a number of rural communities face relatively low average effective tax rates. The rate in Dennis Township is 1.58%, and in Pittsgrove and Plumsted Townships, it is 1.40%.

IV. The Property Tax Rebate

A central element in the package of legislation that includes the state income tax, is a provision for a homeowner property tax rebate. Each homeowner will be entitled to an annual rebate that is related to the amount of local property tax he currently pays. The rebate is calculated so that for each house with a market value in excess of $15,000, the owner is entitled to a rebate of $150 plus $12.50 for each one percent local effective tax rate. Thus, the owner of a house valued at more than $15,000 in Clifton, where the 1974 equalized tax rate is 2% would receive a $175 rebate ($150 + [$12.50 x 2] = $175).

A resident of Trenton, where the tax rate is 6%, who also owned a $15,000 house would be entitled to a rebate of $225 ($150 + [$12.50 x 6] = $225). Homeowners with homes valued at less than $15,000 receive proportionally smaller rebates.

Because the large majority of all houses in the state are valued at more than $15,000 and because most tax rates fall within a range of several percentage points, average rebates per homeowner will not vary substantially across communities. For instance, the average rebate in urban-aid cities is only $9 larger than the average rebate in non-urban-aid communities (see table 5). However, if we add up the total value of rebates expected in one town and divide the total by the number of filing units (tax returns) in that town, significant disparities emerge.

TABLE 5. Average Property Tax Rebates, by Type of Community

COMMUNITY TYPE	AVERAGE REBATE PER HOMEOWNER	AVERAGE REBATE PER UNIT (RETURN)
Urban Aid	$192	$ 36
Non Urban Aid	184	115
Urban, Low SES	$190	$ 35
Urban, Moderate & High SES	190	103
Suburban, Low and Moderate SES	179	123
Suburban, High SES	188	144
Rural, Low, Moderate & High SES	179	101

Average rebates per filing unit in non-urban aid cities are three and a half times larger than average per unit rebates in the urban aid cities. The primary reason for this difference is the significantly larger proportion of renters in urban aid cities.

Renters are, however, entitled to a $65 credit on their income tax. We incorporated these credits in the calculation of tax liability shown in Table 4, above. To the extent that tenants bear the burden of the property tax, the renter's credit attempts to equalize the treatment

of renters and owners. Nevertheless, as with most tax credits, the renter credit is fully paid only to taxpayers with a tax liability in excess of $65. As the larger cities have relatively large numbers of low income households, whose tax liabilities are below $65, the aggregate value of the renter credit is substantially lower in these communities.

Although the rebate per individual homeowner shows little variation, variations in housing values and in tax rates will lead to significant differences among individuals in the proportion of property taxes rebated under this provision of the law. The legislation limits the size of the rebate to 50% of total tax payments. This limit is likely to be reached by household with low valued houses living in low tax rate communities. But the rebate will have a relatively small impact on those paying very high property taxes--those with high valued houses or those facing high tax rates. Thus, within any given town, the rebates will have a larger relative impact on the tax position of those with low valued houses. However, we have found that when you sum up total rebates in a given town and divide them by total property tax payments on owner-occupied houses, this ratio, reflecting the average relative impact of the rebate, shows little variation across types of communities. Aggregate rebates as a percentage of aggregate taxes equals 9.6% in non-urban aid communities, and 10.1% in urban aid communities. Only in suburban-high SES towns is this percentage well below 10%, while in rural communities the average equals 11.5%. We conclude from this that the relative impact of the rebate program on homeowners is approximately equivalent in urban and non-urban communities. Although urban areas have lower average residential property values, they face higher property tax rates than non-urban areas.

V. The School Funding Law (P.L. 212)

In response to the court decision in Robinson v. Cahill, the New Jersey State Legislature passed P.L. 212, which mandated a new set of formulas for state support of public education. In doing so, the state has set up a pattern of support that it hopes will be sufficient to provide "thorough and efficient" education for every public school child.

The new funding formulas, of course, cannot by themselves guarantee thorough and efficient education. They can at best generate a pattern of expenditures across the state, that is judged to result in thorough and efficient education. The questions of how one operationally defines "thorough and efficient," and whether higher funding levels will in fact guarantee higher quality education are beyond the scope of this paper.

P.L. 212 results in substantial increases in state aid to education for all types of school districts. Table 6 presents data on average expenditures and average state aid per pupil and per taxing unit across the districts in our sample. Urban school districts receive considerably higher levels of per pupil aid than do non-urban districts.

TABLE 6. Educational Expenditures and State Educational Aid Per Pupil and Per Taxing Unit (Return)

COMMUNITY TYPE	PER PUPIL EDUCATIONAL EXPENDITURES 1975-1976	STATE AID PER PUPIL 1975-1976	STATE AID PER PUPIL 1976-1977	STATE AID PER TAXING UNIT (RETURN) 1976-1977
Urban Aid	$1357	$688	$937	$439
Non Urban Aid	1474	222	381	231
Urban, Low SES	$1343	$696	$913	$428
Urban, Moderate & High SES	1529	286	486	259
Suburban, Low & Moderate SES	1297	261	377	301
Suburban, High SES	1730	189	306	218
Rural, Low, Moderate & High SES	1321	438	758	504

Among non-urban districts, however, the rural districts receive relatively high per pupil aid. Although the dollar increases in per pupil aid between 1975-76 and 1976-77 have been higher--$249 versus $159--for urban as opposed to non-urban districts, the rate of growth in per pupil aid has been higher for the non-urban districts. Total per pupil aid to the non-urban districts in our sample increased by 71.6% while per pupil aid to the urban districts climbed 36.2%.

It is also interesting to look at the implied effect of state educational aid on local tax payers. The final column of Table 6 lists total state aid per taxing unit. The difference in aid levels between urban and non-urban areas is reduced substantially, both in absolute and percentage terms. Per unit aid to rural districts is considerably higher than per unit aid to low SES urban areas. The primary reason for the different aid patterns is that the ratio of pupils to taxpaying units in non-urban areas is considerably higher than in urban areas. As a consequence, the aggregate flow of state educational aid to urban areas is smaller than might be suggested by the per pupil data alone.

Although we can calculate state aid to various communities for the current fiscal year, it is much more difficult to preduct the long run pattern of state aid. The amount of state equalization aid which a district receives depends on the amount of local revenue that each community decides to contribute to the public schools. An increase or decrease in local support for education will affect the state aid received. Thus, the long run effect of the new state aid formula as well as the long run prospects for "thorough and efficient" funding of education will depend as much on local decisions as on the precise dollar amounts allocated under Public Law 212. Can we anticipate or predict the long-term effects of the new formulas for educational aid on local

support of education?

Equalization aid--the most important element of the new state aid package--is distributed through a type of formula which has seen widespread use in recent years--percentage equalization. A percentage equalization formula attempts to equalize the size of the effective tax base across communities. The formula does so by tying the amount of per pupil state aid which a district receives to the per capita equalized property value in the community. The proportion of total per pupil expenditures in the local school district supplied by the state will be inversely related to the local tax base. In other words, districts with lower property values will recieve a larger percentage of their total school expenditures from the state. The size of the actual state grant depends, however, on the expenditure decision of the local school district. Districts which choose to spend more, up to a certain limit, will receive more aid. Therefore, to predict the long run pattern of state aid for education we must anticipate the reactions of local school boards to any changes in their fiscal environment. If a school board were to reduce the local support for education that could also cut the amount of state aid received.

Will the new aid formulas contained in P.L. 212 affect the rates of taxation in support of public education? Economic theory provides us with some guidance in answering this question. The theory suggests that local governments will spend more if their incomes increase through the receipt of additional tax revenue or higher grants-in-aid. Second, the theory suggests that local governments will want to buy more units of a particular service if the "price" of that public service declines. Price in this context refers to the cost to local tax payers of spending each additional dollar on public

education. If the state were to provide a one-for one matching grant--that is contributing one dollar for each dollar raised by the local government--then the price of public education to the local government would be cut in half. Such a drop in "price" would, economic theory predicts, lead to the purchase of additional "units" of educational services.

The equalizing aid formula in the new legislation is designed to provide the maximum reduction in the "price" of public education to those school districts with the lowest property values. In general, New Jersey's urban communities can be characterized as being "property poor." The average per capita value of real property in urban-aid communities is $6,309 (1974 data), as compared to an average value of $16,260 in our non-urban aid sample, and the state wide average of $11,863. Property value is even lower than the urban average for several of the state's largest cities--$4,272 in Newark, $3,999 in Camden, $5,402 in Paterson, and $4,343 in Trenton.

Because the cities are "property poor," the new formula insures that a high proportion of their expenditures will come from state aid. Thus, local school boards in urban districts face relative low "prices" for extra educational expenditures. According to economic theory, this should stimulate the level of educational expenditures in these urban districts.

Several important factors could, however, counteract or even negate this outcome. First, the equalizing formula in the legislation specifies that the state's share of local educational expenditure will be liminted to a "support limit" equal to the 65th percentile, from low to high, of per pupil current educational expenditures. For the current year, the support limit is $1,528 per pupil. This implies that any school district that was spending more than $1,528 per pupil in 1975 will not be entitled to additional state equalizing aid if they raise their level of educational expenditures. This year, six urban aid cities are affected by this provision. We thus expect a smaller stimulative impact on school spending levels in these cities.

Second, the new educational funding law includes provisions for a so-called "cap" on expenditures. The "cap" limits the annual increases in a school district's per pupil expenditures. Districts with low relative expenditures (their per pupil current expense budgets are less than the state average net per pupil current expense budget) can increase their expenditures faster than the district with relatively high expenditures. The further a district's current per pupil budget falls below the state average, the larger its increases can be. Many of the urban districts are already spending high relative amounts on education. Thus, the "cap" sets fairly tight limits on their expenditure increases. (Parenthetically, it should be noted that the "cap" will place particular burdens on school districts with high per pupil costs especially when those costs stem from the provision of special or compensatory educational services or from higher input prices related to doing business in an urban environment.)

Third, because of the large size of the necessary "minimum bundles" of municipal services and the very limited local resources available to provide those services many local school boards will face political pressure in their communities not to increase educational expenditures by the amount of the new state aid, but rather to substitute state aid for local revenue and in effect free that local revenue for property tax relief or for provision of some municipal services. Although the new funding formula reduces the "price" of educational services to many local communities, there is some initial evidence indicating that communities are not increasing levels of educational spending, presumably because of the heavy burden which the provision of other municipal services places on their residents.

Fourth, population shifts in response to fiscal changes may alter the long run impact of these changes. For example, some families may decide to move into school districts receiving substantial increases in state aid to education, or some may decide to move out of districts with smaller increases. These changes may in turn influence local support for education. If the families moving into a district have a strong preference for education, they may, through the political process, influence the level of local tax effort in support of education. This would in turn shift the patterns of state aid to local districts. Such population movements to or from any given community may also result in the long run bidding-up or bidding-down of property values in that community. Such changes in property values would also result in further changes in the amount of state aid received.

This discussion should make clear that accurate long-run predictions of public education support levels are difficult. Hence, any immediate assumptions about the effectiveness of the new school funding legislation are risky. Although the new equalization aid formula is designed to lessen the correlation between community wealth and the level of expenditures on education, this result will not be achieved unless local school districts react in a specified way to the incentives built into the new aid formulas.

VI. Conclusion

In this paper we have examined the separate impacts of New Jersey's recent fiscal reforms on urban and non-urban residents and communities. To summarize, we now want to look at the combined effect of all these legislative measures on the average citizen in each type of community. By implication this analysis also allows us to compare

the combined effects of these measures on urban and non-urban municipal governments since the composition of the citizenry will, through the workings of the political process, strongly affect how local governments, whether they be municipalities or school districts, react to the tax changes.

The analysis of the income tax, presented earlier has led us to conclude that the average impact of the income tax package is not very different in urban communities as compared to non-urban communities. As gross income per tax paying unit is approximately 60% higher in non-urban areas, it is not suprising that the average per unit income tax payment is higher in non-urban areas ($330 as compared to $173). However, because of the relative distribution of low income exemptions, and high income filing units, the effective tax rate (taxes as a percentage of gross income) is one fourth again as much in non-urban areas--1.66% compared to 1.33%.

As the proportion of homeowners is considerably higher in non-urban areas, and the proportion of low valued houses is smaller, the average rebate per taxpaying unit is substantially higher in non-urban areas, $115 as compared to $36. It should be emphasized that the average impact of rebates on homeowners is quite similar in urban and non-urban areas. Rebates to homeowners as a percentage of property tax payments by homeowners equal 10.1% in urban areas and 9.6% in non-urban areas.

In order to summarize the impact of all of the new tax legislation, we can substract the average per unit rebate from the average per unit income tax payment. This average net tax payment is $138 in urban areas and $215 in all non-urban areas. The non-urban

average conbines a net payment of slightly over $100 in rural areas, with an average net payment of nearly $250 in suburban areas. Although the average net tax payment is higher in non-urban areas, when we adjust for the higher level of gross income in non-urban areas, the effective net tax rate (taxes as a percentage of gross income) is nearly identical in urban and non-urban areas, 1.35% as compared to 1.31%. Thus, the new taxes and rebates when considered togehter do not work to the particular advantage or disadvantage of either urban or non-urban communities.

We now turn our attention to the impact of the school funding law, P.L. 212, on urban and non-urban communities. The court in Robinson v. Cahill mandated the provision of "thorough and efficient" education in all school districts in the state. Although the precise meaning of this expression is not clear, it appears that the Court expected the level of per pupil expenditures to be increased in previously "low spending districts." Some urban districts, with their concentration of poor and poorly educated children, were also expected to increase their level of educational spending in order to meet the "thorough and efficient" provision.

The 1976-77 allocation of funds by P.L. 212 indicates an average per pupil allocation in urban aid districts of $937, nearly two and a half times the $381 average non-urban allocation and a substantial increase over prior levels. Will districts that receive large grants-in-aid under P.L. 212, in fact use this aid to increase their per pupil spending levels. As suggested above, the "caps" provision of the new school funding law will limit any increases in educational expenditures in many urban districts (those districts which already have relatively high per pupil expenditures). Also the existence of extremely high levels of municipal overburden in many urban districts, in addition to high school tax rates suggest that at

least some districts may chose to reduce tax burdens with the new school aid. rather than increase the level of school support. In other words, each district is faced with a limited trade-off between increasing the level of school spending, and reducing their tax burden. The first option, using state aid to increase the level of education spending, is consistent with a movement towards thorough and efficient education, while the second option, using state aid as a substitute for locally raised tax revenues, will help reduce what many consider to be the excessive burden of providing public services in urban areas.

Although we are unable to predict accurately the direction local governments will follow, we can indicate the bounds of possible action by considering the impacts of P.L. 212 if the entire increase in funding is allocated towards increased school spending, or alternatively, if the entire amount is used to reduce taxes.

If the entire amount of increased state aid for education between 1974-75 and 1976-77 is used to increase spending on education, spending would have increased by $227 per pupil in urban aid districts, and $124 per pupil in non-urban aid districts. In percentage terms, this is equivalent to a 40% increase in aid in urban districts, and a 47% increase in non-urban districts. The larger percentage increases in non-urban areas deserve some comment. In 1974-75, school aid was distributed according to a formula that gave increased aid to districts in proportion to the number of children who came from families receiving Aid for Dependent Children (AFDC). This provision is absent from P.L. 212. Urban districts happen to have the largest proportion of children from families receiving AFDC so with this factor eliminated other districts experienced higher rates of increase. It should also be pointed out that by far the largest potential increase

in school funding will occur in rural communities. They experienced an 81% increase in per pupil state aid since 1974-75.

If, on the other hand, the entire two year increase in state education aid was used to reduce local property taxes, tax rates in urban aid cities could be reduced an average 11.4%, and in non urban aid communities 5.7%. Although this would result in a relatively greater reduction in urban tax burdens, the gap between urban and non-urban tax burdens would remain large. As of 1974-75, average urban tax rates were 1.95 times the non-urban rates. After the above reductions, average urban rates would still be 1.84 times average non-urban rates. This result should not be suprising in light of our earlier finding that municipal overburdens were nearly five times higher in urban areas, and the fact that P.L. 212 includes no provision that directly addresses the causes of high municipal tax burdens.

Exact predictions of the response of local governments to the new legislation will require a considerable amount of carefully designed research. At this stage, we can conclude that the composite impact of the new tax and the school funding legislation is favorable to the fiscal position of New Jersey's urban communities. However, because the fiscal problems of urban local governments are significantly more serious than the problems of non-urban local governments, the new legislation does not do very much to improve the poor relative fiscal position of urban governments.